

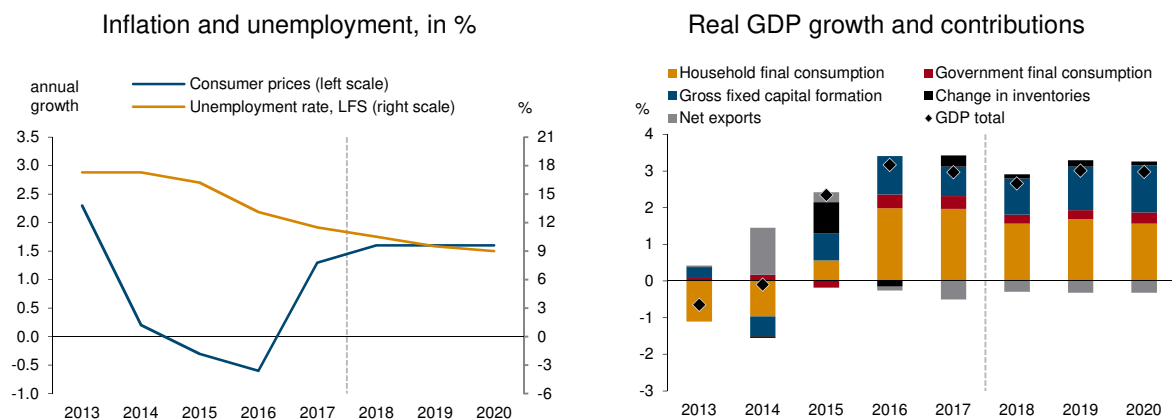


CROATIA: Moderate growth ahead

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Croatia's GDP is projected to grow by up to 3% in the period 2018-2020, driven primarily by domestic demand. The general government is expected to report low deficits or even a surplus, and thus the debt-to-GDP ratio will continue declining gradually. The impact on growth of the Agrokor food-to-retail consortium's restructuring is still unknown.

Figure 44 / Croatia: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

Croatia's real GDP grew by 3% year on year in 2017. Growth was supported by domestic demand: both private consumption and investments expanded. Private consumption growth was at its highest level since the onset of the global financial crisis, gaining momentum thanks to rising employment, real wage increases and rising household loans. Gross fixed capital formation went up only modestly, probably on account of the financial problems of the Agrokor group. The contribution of net exports was negative, due to rising imports. Industrial production grew less dynamically than in 2016, and was up by some 2.3% in 2017. Construction output rose by only 2%, but activities in this sector, the construction of buildings in particular, intensified towards the end of the year. Also the recent survey of business expectations shows growing business confidence in construction, which had suffered from a long and deep downturn in the aftermath of the crisis.

The labour market situation has continued to improve, but unemployment is still high by European standards. According to Labour Force Survey data, employment increased by 1.7%, while the unemployment rate fell to slightly below 12% in 2017. The fall in unemployment was mainly due to continued emigration and ageing of the population, and was only partly a result of rising employment. Real net wages increased by almost 4% in 2017, on account of income tax changes and as a result of both private and public sector wage increases. The rise in public sector wages – including those of civil servants and government employees – took place in three stages, growing by 2% in each of the months of January, August and November.

Foreign trade picked up in 2017, and both exports and imports of goods have experienced strong growth (12.5%) in euro terms. The trade deficit was an estimated EUR 900 million higher than in 2016, while the surplus in the services trade rose, thanks to another record-breaking tourist season. Tourism continued to benefit from the political uncertainties in Turkey and Northern Africa. The repatriation of profits was lower, as banks absorbed losses from Agrokor. Hence, the current account recorded a strong surplus in 2017, at an estimated 4% of GDP. The inflow of FDI was somewhat lower compared with 2016, at EUR 1.5 billion.

In 2017, the general government ran the first surplus in the country's history, resulting from higher than expected revenues. The primary budget closed with a surplus for the second consecutive year. The reduction in the deficit also translated into a reduction in public debt, to an estimated 78% of GDP (from 82.7% in 2016). The budget plans approved in November 2017 envisage a budget deficit of 0.5% of GDP in 2018, a balanced budget in 2019 and a surplus of 0.8% in 2020. Reaching these targets will be very important, given the authorities' intentions of adopting the euro in the foreseeable future. In January 2018, Fitch upgraded Croatia's credit rating for the first time since 2004 – from 'BB' to 'BB+' – on account of strong revenues from tourism, the current account surplus and the improvement in public finances, among other things.

A first draft of settlement with the creditors of Agrokor foresees a debt-for-equity swap and a debt write-off. Accordingly, the creditors – suppliers, bondholders and banks – should become owners of a newly established (downsized) holding, including the profitable parts of the company. The non-profitable parts will undergo bankruptcy procedures, and part of the claims will be written off. As for the time line of the settlement, the crisis manager of Agrokor, Mr. Ramljak, asked for an extension of the deadline by three months until July at the latest. The intention is also to get Sberbank, the single biggest creditor, on board for a settlement; Sberbank had earlier launched legal action against Agrokor firms. The settlement with creditors requires the backing of creditors holding at least two-thirds of the claims, totalling about EUR 7.4 billion. Along with the adoption of an emergency law, which is to prevent the company from starting bankruptcy proceedings, the management of the company was handed over to a government-appointed manager in April 2017. So far new loans have been provided to pay out old debt of small suppliers and to ensure the continuation of regular business operations.

The introduction of the euro is one of the stated aims of the government and the Croatian National Bank. This was laid down in a joint strategy, presented at the beginning of November 2017. Croatia's economy is highly euroised: three-quarters of domestic savings and two-thirds of debts are denominated in euro. With respect to the convergence criteria, Croatia does not yet fulfil the criterion on sustainable public finances (the debt-to-GDP ratio is above 60%). Apart from further fiscal adjustments, for Croatia to join the ERM II it will be important to get the support of EU Member States and institutions

– provided they are willing to enlarge the eurozone. The application for ERM II entry and eventual adoption of the euro has to be done in consultation with EU institutions. According to Prime Minister A. Plenković, Croatia wants to enter ERM II before the country takes over the presidency of the European Union in 2020.

GDP growth is forecast to be around 3% in the period 2018-2020, driven by private consumption and a continued recovery in investments. Investments are expected to intensify, spurred by an increased absorption of EU funds, while household consumption will be driven by a further improvement in the labour market, along with rising wages. Inflation is expected to remain moderate, at below 2%, over the forecast period. As the strengthening of domestic demand will lead to rising imports, the trade deficit will increase further, but will largely be offset by the surplus in services due to high earnings from tourism. Hence, the current account surplus will persist, but will gradually decrease from an estimated 4% in 2017 to less than 1% in 2020. Assuming that the general government closes with even a slight surplus in the coming years, the public debt is expected to continue its downward path in the forecasting period. Downside risks are related to the potential impact of the Agrokor case, which may affect exports or private consumption if there are substantial layoffs during the restructuring of the company. In the longer run, demographic issues – the shrinking of the working-age population due to population ageing and continued emigration – constitute an additional downside risk. If Croatia were to settle a number of bilateral issues, the country could join important institutions that would give the economy an additional positive spin.

Becoming a member of the Schengen area and the OECD, which are among the foreign policy priorities for 2018, might be further blocked by Slovenia and Hungary. Slovenia wants to block Croatia's bid for membership so long as Croatia rejects the ruling of the international arbitration tribunal on the bilateral border dispute, while Hungary withdrew its support over tensions due to the INA-MOL oil company dispute.

Table 14 / Croatia: Selected economic indicators

	2013	2014	2015	2016	2017 ¹⁾	2018	2019	2020
						Forecast		
Population, th pers., average	4,254	4,236	4,208	4,172	4,150	4,100	4,050	4,000
Gross domestic product, HRK mn, nom.	331,374	331,266	338,975	349,410	364,500	380,200	397,900	416,300
annual change in % (real)	-0.6	-0.1	2.3	3.2	3.0	2.7	3.0	3.0
GDP/capita (EUR at PPP)	16,000	16,300	17,200	17,500	18,100	.	.	.
Consumption of households, HRK mn, nom.	195,623	191,407	192,250	196,505	206,020	.	.	.
annual change in % (real)	-1.9	-1.6	1.0	3.5	3.5	2.8	3.0	2.8
Gross fixed capital form., HRK mn, nom.	65,257	63,797	66,401	69,516	73,240	.	.	.
annual change in % (real)	1.4	-2.8	3.8	5.3	4.0	5.0	6.0	6.5
Gross industrial production ²⁾								
annual change in % (real)	-1.8	1.2	2.7	5.3	1.4	2.5	3.0	3.0
Gross agricultural production								
annual change in % (real)	5.5	-6.9	2.9	6.9	-3.6	.	.	.
Construction output ²⁾								
annual change in % (real)	-4.6	-7.3	-0.6	2.6	2.0	.	.	.
Employed persons, LFS, th, average	1,524	1,566	1,585	1,590	1,600	1,610	1,630	1,650
annual change in %	-2.7	2.7	1.3	0.3	0.6	0.8	1.0	1.0
Unemployed persons, LFS, th, average	318	327	306	240	210	190	170	160
Unemployment rate, LFS, in %, average	17.3	17.3	16.2	13.1	11.5	10.5	9.5	9.0
Reg. unemployment rate, in %, eop	21.5	19.4	17.6	14.7	12.2	.	.	.
Average monthly gross wages, HRK ³⁾	7,939	7,953	8,055	7,753	8,050	8,340	8,640	9,000
annual change in % (real, gross)	-1.4	0.4	1.8	3.0	2.7	2.0	2.0	2.0
Average monthly net wages, HRK ³⁾	5,515	5,533	5,711	5,685	6,000	6,280	6,570	6,900
annual change in % (real, net)	-1.5	0.5	3.7	2.7	4.4	3.0	3.0	3.0
Consumer prices (HICP), % p.a.	2.3	0.2	-0.3	-0.6	1.3	1.6	1.6	1.6
Producer prices in industry, % p.a.	-0.4	-2.7	-3.9	-4.3	1.9	2.0	2.0	2.0
General governm.budget, EU-def., % of GDP								
Revenues	42.4	42.9	44.3	46.2	45.4	44.9	44.0	43.9
Expenditures	47.7	48.0	47.6	47.1	46.3	45.4	44.0	43.4
Net lending (+) / net borrowing (-)	-5.3	-5.1	-3.3	-0.9	-0.9	-0.5	0.0	0.5
General gov.gross debt, EU def., % of GDP	81.7	85.8	85.4	82.7	78.0	76.0	74.0	72.0
Stock of loans of non-fin.private sector, % p.a.	-1.5	-2.0	-3.1	-4.3	0.1	.	.	.
Non-performing loans (NPL), in %, eop	15.7	17.1	16.7	13.8	12.5	.	.	.
Central bank policy rate, % p.a., eop ⁴⁾	7.0	7.0	3.0	3.0	3.0	3.0	3.0	3.0
Current account, EUR mn	415	858	2,019	1,172	1,930	1,100	700	500
Current account, % of GDP	0.9	2.0	4.5	2.5	4.0	2.2	1.3	0.9
Exports of goods, BOP, EUR mn	8,924	9,440	10,193	10,511	11,810	12,800	13,700	14,700
annual change in %	2.9	5.8	8.0	3.1	12.4	8.0	7.0	7.0
Imports of goods, BOP, EUR mn	15,511	15,952	17,168	17,849	20,080	21,900	23,700	25,600
annual change in %	3.6	2.8	7.6	4.0	12.5	9.0	8.0	8.0
Exports of services, BOP, EUR mn	9,844	10,238	11,279	12,269	13,360	14,300	15,200	16,000
annual change in %	2.1	4.0	10.2	8.8	8.9	7.0	6.0	5.5
Imports of services, BOP, EUR mn	3,088	2,900	3,274	3,585	3,960	4,200	4,500	4,800
annual change in %	-2.2	-6.1	12.9	9.5	10.5	7.0	7.0	6.0
FDI liabilities, EUR mn	737	2,297	189	1,699	1,500	.	.	.
FDI assets, EUR mn	-111	1,608	-44	-178	500	.	.	.
Gross reserves of NB excl. gold, EUR mn	12,908	12,688	13,707	13,514	15,706	.	.	.
Gross external debt, EUR mn	45,803	46,416	45,384	41,668	39,800	39,000	39,800	40,500
Gross external debt, % of GDP	104.8	107.0	101.9	89.8	81.5	77.0	75.0	73.0
Average exchange rate HRK/EUR	7.5786	7.6344	7.6137	7.5333	7.4637	7.5	7.5	7.5

1) Preliminary and wiiw estimates. - 2) Enterprises with 20 and more employees. - 3) From 2016 data are based on tax records (survey JOPPD); prior to that data are based on a monthly survey covering 70% of persons in employment. - 4) Discount rate of NB.

Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.